

211 CMR 19.00: AUDITS OF INSURERS BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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19.01: Authority

211 CMR 19.00 is promulgated by the Commissioner of Insurance pursuant to M.G.L. c. 175, §§ 4, 25.

19.02: Purpose

Public hearings were held on October 8, 1975 and, following certain revisions, on December 15, 1975 at which interested persons were invited to comment on proposed Rules and Regulations Regarding Audits of Insurers by Independent Certified Public Accountants.

M.G.L. c. 175, § 4 provides, in part, "Whenever (the Commissioner) deems it advisable he shall cause a complete audit of the books of the company to be made by a disinterested expert accountant."

M.G.L. c. 175, § 4 also provides that, "Whenever (the Commissioner) determines it to be prudent for the protection of policyholders in the Commonwealth, he shall in like manner visit and examine, or cause to be visited and examined...any foreign company."

M.G.L. 175, § 25 provides, in part, "The Commissioner may at other times require any such statements as he may deem necessary."

We have carefully considered the present financial position, the examination process, and the financial surveillance in the insurance industry and find several areas of significant concern.

The number of insolvencies has increased in recent years. In 1975 alone, we were notified of five foreign insolvencies affecting Massachusetts policyholders. Our present examination process is not as effective as it should be in identifying impending insolvencies or reducing their risks. As much as four years now elapse between the date of one examination and the receipt of report of the next. The current annual statement process is an insufficient safeguard in the interim. Despite significant changes in the way companies have kept their books and records over the years, the Massachusetts examination procedure has remained essentially unchanged.

The annual audit requirement set forth in 211 CMR 19.00 is part of an increased vigilance the Division of Insurance finds important to its financial surveillance of companies doing business in Massachusetts. It is a vital complement to the NAIC early warning system, the triennial examination, the strengthened requirements for admission of new companies to do business here, and various internal changes the Division has recently made.

211 CMR 19.00 is not merely an additional reporting requirement. It will mandate companies to have annual independent review, not presently a part of the examination procedure.

19.02: continued

Many insurance companies and other businesses have long recognized that an annual CPA audit makes good business sense. To assure that CPA audits are conducted and the protection of Massachusetts policyholders is thus enhanced, we deem it prudent to promulgate 211 CMR 19.00.

211 CMR 19.00 shall not prohibit, preclude, or in any way limit the Commissioner of Insurance, or his designee, from ordering or conducting or performing examinations of insurers under his jurisdiction as to practices, procedures, financial condition, market conduct and other aspects of the operations of such insurers.

19.03: Definitions

Audited financial report means and includes those items specified in 211 CMR 19.05.

Accountant and Independent Certified Public Accountant mean an independent certified public accountant or firm licensed to practice in the Commonwealth of Massachusetts or in any state with similar licensing requirements and a member in good standing of the American Institute of Certified Public Accountants. It shall also mean, for Canadian and British companies, a Canadian or British chartered accountant.

Insurer means any insurance company doing business in the Commonwealth of Massachusetts under M.G.L. c. 175 and includes, but is not limited to, all life, accident and health, property and liability, title "b" reinsurers and surplus line companies regulated by the Division of Insurance of the Commonwealth of Massachusetts.

Division means the Division of Insurance of the Commonwealth of Massachusetts.

Commissioner means the Commissioner of Insurance or his designee.

19.04: Rule

All insurers shall have an annual audit by an independent certified public accountant and shall file an audited financial report with the Commissioner on or before June 30 for the year ending December 31 immediately preceding.

Extensions of the June 30 filing date may be granted by the Commissioner for 30-day periods upon showing by the insurer or its independent certified public accountant valid justification for such extension. The request for any extension must be received prior to the due date of the audited financial report in sufficient detail to permit the Commissioner to make an informed decision with respect to the requested extension.

The annual audited financial report shall be considered part of the insurer's annual statement filing, except as to the due dates provided in 211 CMR 19.00, as provided by M.G.L. c. 175, § 25 and shall be subject to the penalties provided by M.G.L. c. 175, § 26.

19.05: Contents of Annual Audited Financial Report

- (1) Opinion of Independent Certified Public Accountant (See 211 CMR 19.09).
- (2) Financial Statements (See 211 CMR 19.10).
 - (a) Balance sheet;
 - (b) Statement of gain or loss from operations;
 - (c) Statement of changes in financial position;
 - (d) Statement of changes in capital paid up, gross paid in and contributed surplus and unassigned funds (surplus);
 - (e) Notes to financial statements.
- (3) Report on Evaluation of Internal Control by Independent Certified Public Accountant.
- (4) Accountant's Letter (See 211 CMR 19.12).

19.06: Designation of Independent Certified Public Accountant

Insurers required by 211 CMR 19.00 to file an annual audited financial report must, within 90 days after becoming subject to such requirement, report to the Commissioner in writing, the name and address of the independent certified public accountant retained to conduct the annual audits set forth in 211 CMR 19.00. Insurers exempt until the year ended December 31, 1976 under 211 CMR 19.16(3), must provide such notice by June 30, 1976.

All insurers subject to 211 CMR 19.00 shall notify the Commissioner of the engagement of an accountant within 30 days of such appointment if such accountant was not the accountant for purposes of 211 CMR 19.00 for the immediately preceding year. Such notification shall include a statement by the president, treasurer and chairman of the audit committee (if any), as to whether in the 24 months preceding the most recent December 31 there were any disagreements with the former accountant on any matter of accounting principles or practices, financial statement disclosure, or auditing procedures which disagreements if not resolved to the satisfaction of the former accountant would have caused him to make reference to the subject matter of the disagreement in connection with his opinion. The insurer shall also in writing request such former accountant to furnish it with a letter addressed to the Commissioner stating whether he agrees with the statements contained in the insurer's letter and, if not, stating the reasons for which he does not agree; and the insurer shall furnish such responsive letters from the former accountant to the Commissioner together with its own.

19.07: Qualifications of Independent Certified Public Accountant

The Commissioner shall not recognize any person or firm as an independent certified public accountant who is not duly licensed to practice and in good standing under the laws of the Commonwealth of Massachusetts (or in a state with licensing requirements similar to Massachusetts) and a member in good standing of the American Institute of Certified Public Accountants or, for a Canadian or British company, a chartered accountant. Except as otherwise provided herein, a certified public accountant shall be recognized as independent as long as he conforms to the standards of his profession, as contained in the Code of Professional Ethics of the American Institute of Certified Public Accountants, and Rules and Regulations and Code of Ethics and Rules of Professional Conduct of the Massachusetts Board of Public Accountancy (or similar code).

The Commissioner may hold a hearing to determine whether a certified public accountant is qualified under 211 CMR 19.00, whether he is independent, whether an audit performed by him conforms to generally accepted auditing standards, or whether the annual audited financial report on which he has given his opinion presents fairly the financial position and results of operations of the insurer and, considering the evidence presented, may rule that the certified public accountant is not qualified under 211 CMR 19.00, is not independent for purposes of expressing his opinion, did not conduct his audit in accordance with generally accepted auditing standards or that the annual audited financial report on which he gave his opinion did not fairly present the financial position and results of operations of the insurer. After such finding, the Commissioner may require the insurer to replace the accountant.

19.08: Consolidated or Combined Audits

Insurers may file consolidated or combined reports subject to the conditions imposed herein unless the Commissioner in his discretion requires individual audited financial reports for each insurer subject to 211 CMR 19.00.

Insurers who are members of an insurance holding company system or affiliated group may file a consolidated or combined annual audited financial report provided that:

- (1) An organizational chart of all companies included in the consolidation is filed as part of the report;
- (2) A worksheet setting forth the amounts shown on the consolidated or combined audited financial report with a reconciliation to individual amounts shown on the annual statements of the insurers filed with the Commissioner is filed with the report. Such reconciliation may be in columnar form and must include explanations of consolidating and eliminating entries. Non-insurance operations may be combined, or stated separately. Amounts for each insurer subject to 211 CMR 19.00 must be stated separately.

19.08: continued

(3) The ultimate holding company included in each report guarantees all debts and obligations of insurers subject to 211 CMR 19.00 included in such consolidated or combined audited financial report.

Any insurer may file a copy of its annual form 10K filed with the Securities and Exchange Commission, in lieu of the consolidated or combined reports permitted by 211 CMR 19.08, in which case all provisions of 211 CMR 19.08 shall apply.

19.09: Opinion of Independent Certified Public Accountant

Financial statements furnished pursuant to 211 CMR 19.05(2) shall be examined by independent certified public accountants in accordance with generally accepted auditing standards as determined by the American Institute of Certified Public Accountants.

The opinion of the independent certified public accountant shall cover all years presented except that no opinion is required for financial statements or portions thereof prior to December 31, 1975.

The opinions on the financial statements filed pursuant to 211 CMR 19.05(2) shall be relative to conformity with accounting practices prescribed or permitted by the Division of Insurance of the Commonwealth of Massachusetts or the insurers' state of domicile. Insurers may elect to present financial statements filed pursuant to 211 CMR 19.00 on the basis of generally accepted accounting principles so long as such statements contain reconciliations of surplus (or shareholders equity) and results of operations from the basis of generally accepted accounting principles to the statutory basis of accounting.

The opinion shall be addressed to the insurer on stationery of the accountant showing the address of issuance, shall bear original manual signatures and shall be dated.

19.10: Contents of Audited Financial Statements

(1) General. In general and except as otherwise provided herein, the financial statements filed pursuant to 211 CMR 19.05(2) should be prepared in a form and using language and groupings substantially the same as the relevant Sections of the annual statement of the insurer filed with the Commissioner, and:

- (a) The financial statements shall be comparative, presenting the amounts as of December 31 of the current year and the amounts as of the immediately preceding December 31.
- (b) Amounts may be rounded to the nearest \$1,000.
- (c) Supporting schedule, exhibit, part and item references and line numbers may be omitted.
- (d) Inapplicable captions need not be included.
- (e) Insignificant amounts may be combined.
- (f) Notes to the financial statements should be appropriately cross-referenced on the face of all financial statements.
- (g) If an insurer files financial statements on a statutory basis and also prepares financial statements on the basis of generally accepted accounting principles or the insurer is included in consolidated or combined financial statements prepared on the basis of generally accepted accounting principles, such financial statements must also be included in the filing of the audited financial report.

(2) Balance Sheets. The balance sheets of the insurer shall be prepared in a form and using language and groupings substantially the same as that contained in the insurer's annual statement filed with the Commissioner except as noted in 211 CMR 19.10(1).

(3) Statement of Gain or Loss from Operations. The statement of gain or loss from operations shall be prepared in a form using language and groupings substantially the same as the income statement contained in the insurer's annual statement filed with the Commissioner except as noted in 211 CMR 19.10(1).

19.10: continued

(4) Statement of Changes in Financial Position. The statement of changes in financial position shall be prepared in accordance with Accounting Principles Board Opinion Number 19, except where such opinion conflicts with statutory accounting and:

- (a) Purchases of long term securities shall be stated separately, as one item.
- (b) Sales of long term securities shall be stated separately, as one item.
- (c) Purchases and sales of short term securities shall be stated net, as one item.

(5) Statement of Changes in Capital Paid Up, Gross Paid in and Contributed Surplus and Unassigned Funds (Surplus). Such statement shall be prepared in a suitable format and shall include, as separate items, the information included in the capital and surplus account of the insurer's annual statement filed with the Commissioner. Such statement shall include separate presentations of changes in capital paid up, gross paid in and contributed surplus and unassigned funds (surplus).

(6) Notes to Financial Statements. The notes to financial statements shall be those required by generally accepted accounting principles, and shall include:

- (a) A reconciliation of differences, if any, between the audited financial report and the annual statement of the insurer filed with the Commissioner;
- (b) A summary of ownership and relationships of the insurer and all affiliated companies;
- (c) A narrative explanation of all significant intercompany transactions and balances.

(7) S.E.C. Form 10K. Any insurer may file a copy of its annual form 10K filed with the Securities and Exchange Commission, in lieu of the financial statements required by 211 CMR 19.05(2) which shall bear original manual signatures of the officers of the insurer and its independent certified public accountants as required by the Securities and Exchange Commission. This shall be applicable to both separate company financial statements and consolidated or combined statements permitted by 211 CMR 19.08.

19.11: Report on Evaluation of Internal Control by Independent Certified Public Accountant

In connection with the independent certified public accountant's examination of the financial statements of the insurer as required by 211 CMR 19.00, he shall report on his evaluation of the internal controls of the insurer.

Internal controls comprise the plan of organization and all of the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency and encourage adherence to prescribed managerial policies.

The auditor should be primarily concerned with accounting controls which comprise the plan of organization and all methods and procedures that are concerned mainly with, and relate directly to the safeguarding of assets and reliability of the financial records. They generally include such controls as the systems of authorization and approval, separation of duties concerned with record keeping and accounting reports from those concerned with operations or asset custody, physical controls over assets and internal auditing.

If the auditor believes, however, that certain administrative controls may have an important bearing on the reliability of the financial records, he should consider the need for evaluating such controls. Administrative controls comprise the plan of organization and all methods and procedures that are concerned mainly with operational efficiency and adherence to managerial policies and usually relate only indirectly to the financial records.

The accountant's review of the internal controls shall be conducted in accordance with generally accepted auditing standards and this report thereon shall be in accordance with pronouncements of the American Institute of Certified Public Accountants and may be in a form suggested by Section 640, Statement of Auditing Standards and Procedures Number One of the American Institute of Certified Public Accountants.

The insurer shall file the report on internal controls by the independent certified public accountant with the Commissioner. Such reports shall be addressed to the insurer on stationery of the accountant showing the address of issuance, shall bear original manual signatures and shall be dated.

19.12: Accountant's Letter

The accountant shall furnish the insurer in connection with, and for inclusion in, the filing of the audited annual report, a letter stating:

- (1) That he is independent with respect to the insurer and conforms to the standards of his profession as contained in the Code of Professional Ethics and pronouncements of the American Institute of Certified Public Accountants, pronouncements of the Financial Accounting Standards Board, and the Rules of Professional Conduct of the Massachusetts Board of Public Accountancy (or similar code).
- (2) The background and experience in general, and the experience in audits of insurers of the staff assigned to the engagement and whether each is an independent certified public accountant. Nothing within 211 CMR 19.00 shall be construed as prohibiting the accountant from utilizing such staff as he deems appropriate where such use is consistent with the standards prescribed by generally accepted auditing standards.
- (3) That the accountant understands that the annual audited financial report and his opinions thereon will be filed in compliance with 211 CMR 19.00.
- (4) That the accountant consents to the requirements of 211 CMR 19.14 and that the accountant consents and agrees to make available for review by the Commissioner, his designee or his appointed agent, the work papers, as defined in 211 CMR 19.14.
- (5) A representation that the accountant is properly licensed by an appropriate state licensing authority and that he is a member in good standing in the American Institute of Certified Public Accountants.

19.13: Notification of Adverse Financial Condition

Insurers subject to this Rule shall require the independent certified public accountant to immediately notify in writing an officer and all members of the Board of Directors of the insurer of any determination by the independent certified public accountant that the insurer has materially misstated its financial condition as reported to the Commissioner for the year ended December 31 immediately preceding. The insurer shall furnish such notification to the Commissioner within five days of receipt thereof.

If the accountant, subsequent to the date of the audited financial report filed pursuant to 211 CMR 19.13, becomes aware of facts which would have affected his report, the Division notes the obligation of the accountant to take such action as prescribed by Section 561 of the Statement of Auditing Standards Number One of the American Institute of Certified Public Accountants.

19.14: Availability and Maintenance of Working Papers of the Independent Certified Public Accountant

Insurers subject to 211 CMR 19.00 shall require the independent certified public accountant to make available for review by the Commissioner of his appointed agent, the work papers prepared in the conduct of the audit of the insurer which shall include its parent and affiliates as they relate to the examination of the insurer. The insurer shall require that the accountant retain the audit work papers for a period of not less than five years after the period reported upon.

The aforementioned reviews by the Commissioner shall be considered investigations and all working papers obtained during the course of such investigations shall be confidential. The insurer shall require that the independent certified public accountant provide photocopies of any of the working papers which the Division considers relevant which may be retained by the Division.

"Work Papers", as referred to in 211 CMR 19.14 include, but are not necessarily limited to, schedules, analyses, reconciliations, abstracts, memoranda, narratives, flow charts, copies of company records or other documents prepared or obtained by the accountant and his employees in the conduct of their examinations of the insurer.

19.15: Examination by the Commissioner

The Commissioner shall determine the nature, scope and frequency of examinations conducted by the Division at the direction of the Commissioner pursuant to M.G.L. c. 175, § 4. Such examinations may, but need not cover all aspects of the insurer's assets, condition, affairs and operations and may include and be supplemented by audit procedures performed by independent certified public accountants as herein provided. Scheduling of examinations will take into account such matters as National Association of Insurance Commissioners guidelines, early warning text results, changes in management, results of market conduct examinations and audited financial reports. The type of examinations under the provisions of 211 CMR 19.00 performed by Division examiners after the effective date of this Rule shall be as follows:

(1) Financial Surveillance will consist of a review of the audited financial report and annual statement and may include a review of the independent certified public accountant's working papers as defined under 211 CMR 19.14, and a general review of the insurer's corporate affairs and insurance operations to determine compliance with Massachusetts General Laws and the Rules and Regulations of the Division. The examiners may perform alternative or additional examination procedures to supplement those performed by the independent certified public accountant when the examiners determine that such procedures are necessary to verify the financial condition of the insurer. No accountant's working papers should be furnished unless expressly required.

(2) Targeted Examinations will cover specific areas of an insurer's operations as the Commissioner may deem appropriate.

(3) Comprehensive Examinations will be performed when the report of the accountant as provided for in 211 CMR 19.04 or the notification required by 211 CMR 19.13 or the results of compliance or targeted examinations or other circumstances indicate in the judgment of the Commissioner that a complete examination of the condition and affairs of the insurer is necessary. Such examinations may be conducted by Division personnel or by independent certified public accountants selected by the Commissioner, at the discretion of the Commissioner.

At the completion of each examination described above, the examiner appointed by the Commissioner shall make a full and true report on the results of the examination. Each report shall include a general description of the scope of the examination performed and the extent to which the examiners utilized the work of accountants for the insurer or other certified public accountants to supplement their examination

The cost of all work performed by independent certified public accountants shall be borne by the insurer.

19.16: Application and Effective Date

211 CMR 19.00 *et seq.* shall apply to all insurers doing business in the Commonwealth of Massachusetts and shall be effective March 15, 1976. Insurers shall comply with the provisions of 211 CMR 19.00 for all annual audits conducted for the years ending December 31, 1990 and before. Annual audits conducted for years ending December 31, 1991 and after, shall be filed in accordance with the provisions of 211 CMR 23.00 *et seq.*

Insurers which engaged independent certified public accountants for an annual audit for the year ended December 31, 1975 must file an annual audited financial report as required by 211 CMR 19.00 *et seq.* for the year ended December 31, 1975 on or before October 31, 1976 and by June 30 of each year thereafter.

Insurers having not engaged an independent certified public accountant for an annual audit for the year ended December 31, 1975 shall not be required to file an annual audited financial report until the year ended December 31, 1976 which shall be due on June 30, 1977. Insurers electing this later effective date must so notify the Commissioner, in writing, by June 30, 1976.

211 CMR 19.00 *et seq.* shall cease to be in effect when and if the Commissioner determines, at his discretion, that the National Association of Insurance Commissioners has adopted a model regulation which can be substituted for 211 CMR 19.00 without loss of effectiveness.

19.17: Exemptions

Upon written application of any insurer, the Commissioner may grant an exemption from compliance with 211 CMR 19.00 or portions thereof if the Commissioner finds, upon review of the application, that compliance with 211 CMR 19.00 would constitute a financial or organizational hardship upon the insurer or its independent certified public accountant. An exemption may be granted at any time for any specified period. Within ten days from a denial of an insurer's written request for an exemption from 211 CMR 19.00, such insurer may request in writing a hearing on its application for exemption. Such hearing shall be held in accordance with M.G.L. c. 30A and the practices of the Massachusetts Division of Insurance pertaining to administrative hearings.

Insurers having premiums written in Massachusetts of less than \$100,000 in any year and having less than 1,000 Massachusetts policyholders at the end of any year are exempt from 211 CMR 19.00 for such year.

19.18: Severability

If any provision of 211 CMR 19.00 or application thereof to any regulatee is held invalid, such invalidity shall not affect other provisions of 211 CMR 19.00 and, to that end, the provisions of 211 CMR 19.00 are severable.

REGULATORY AUTHORITY

211 CMR 19.00: M.G.L. c. 175, §§ 4 and 25.